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ABSTRACT

This report describes the activities of five federal agencies as they made the transition from merit pay to the Performance Management and Recognition System (PMRS) during fiscal year 1985. It also discusses how PMRS addressed the problems identified with merit pay. In addition, the report presents information on the pay increases and performance awards provided to PMRS employees in fiscal year 1985 and discusses the initial perceptions of selected employees on PMRS operations. Some of the findings of the study are that the agencies lacked lead time in implementing the new system, that the change was difficult, that some agencies incorrectly calculated pay increases, and that continuing problems exist such as significant differences among the agencies in raises for employees with the same grade and rating, and with the distribution of ratings. Employees express distrust of the performance appraisal systems and are concerned that insufficient funds are available to reward performance adequately. The General Accounting Office recommends that the formula for computing general pay increases be clarified; other recommendations were not made in this report because PMRS has been in use for only one year. (KC)

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United States General Accounting Office
Report to Congressional Requesters

January 1987

PAY FOR PERFORMANCE

Implementation of the Performance Management and Recognition System



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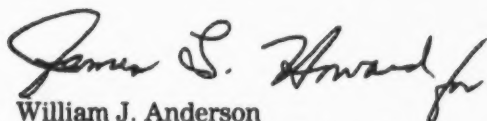
The Honorable William D. Ford
Chairman, Committee on Post Office
and Civil Service
House of Representatives

The Honorable Mary Rose Oaker
Chair, Subcommittee on Compensation and
Employee Benefits
Committee on Post Office and Civil Service
House of Representatives

This report responds to your request that we review in selected federal agencies the implementation of legislative changes to the government's merit pay system. These changes, which were enacted in November 1984, constitute the Performance Management and Recognition System (PMRS).

The report describes the activities of five federal agencies as they made the transition from merit pay to PMRS during fiscal year 1985. It also discusses how PMRS addressed the problems identified with merit pay and the problems that still exist under PMRS. In addition, the report presents information on the pay increases and performance awards provided to PMRS employees in fiscal year 1985 and discusses the initial perceptions of selected employees on PMRS operations.

As arranged with the Subcommittee on Compensation and Employee Benefits, we will not release this report until 14 days from its issue date, unless you publicly announce its contents earlier. At that time, we will distribute copies to the five agencies covered in this report and to other interested parties upon request.



William J. Anderson
Assistant Comptroller General

Executive Summary

Purpose

Because of concerns that problems were occurring, the Chairman, House Committee on Post Office and Civil Service, requested GAO to review the implementation of legislative changes to the government's merit pay system. In November 1984, the Congress had enacted these changes which constituted the Performance Management and Recognition System (PMRS). PMRS, which covers federal supervisory and managerial employees, was intended to strengthen and improve the pay for performance principles introduced by the merit pay system.

Background

The merit pay system—established by the Civil Service Reform Act of 1978—fundamentally changed the manner in which most of the government's GS-13 through 15 supervisors and managers were compensated. These employees no longer received the annual salary adjustments, within-grade increases, and quality step increases previously available to them under the General Schedule pay system. Instead, they received a reduced annual salary adjustment and had to compete for merit pay increases from a fixed merit pay fund based on how well they performed their jobs.

Merit pay did not work as well as had been expected. Numerous problems and inequities were identified, many of which were discussed in GAO's report entitled A 2-Year Appraisal of Merit Pay in Three Agencies (GAO/GGD-84-1, March 26, 1984). In general, the problems centered around shortcomings in the agencies' performance appraisal systems and the influence of nonperformance-related factors on employees' merit pay increases.

PMRS was intended to correct the difficulties experienced with the merit pay system by making the new system more equitable than merit pay when compared to the General Schedule. The new system retained the pay for performance principles introduced under merit pay by requiring that employees receive pay increases and performance awards based on quality performance. This report discusses the results of GAO's review in five federal agencies. GAO's findings cannot be projected to all federal agencies.

Results in Brief

The Office of Personnel Management (OPM) and the agencies lacked lead time to prepare for implementing PMRS because the law was signed approximately 1 month after it was to have become effective. During

the initial months of the new system's implementation, OPM issued guidance and regulations that at times were untimely, inconsistent with the PMRS law, or unclear.

Despite the resulting confusion and various administrative difficulties, three of the four agencies from which GAO obtained personnel data provided their employees with general pay and merit increases and performance awards in accordance with the law. The fourth agency miscalculated the general pay increases for many of its PMRS employees which could result in some of these employees receiving erroneous merit increases in future years.

Certain nonperformance-related factors that caused inequities under merit pay continue to exist in PMRS. Performance award amounts varied considerably for employees with the same grades and performance ratings. It is possible that this difficulty could be overcome as agencies gain experience under PMRS. But, as long as agencies must limit the funds to be made available for general pay increases, merit increases, and performance awards, it is not apparent to GAO how agencies can completely overcome the effects of nonperformance-related factors.

Principal Findings

The Transition From Merit Pay to PMRS Was Difficult

OPM and the agencies had to incorporate the numerous changes created by PMRS into their pay systems in an extremely short period of time. PMRS was enacted on November 8, 1984, but was effective retroactively to October 1, 1984.

The lack of preparation time caused administrative difficulties for the agencies. For example, the agencies GAO visited were not able to train and inform their employees about the new system before implementing it. Moreover, performance awards were not always given to employees in a timely manner.

OPM faced similar difficulties in fulfilling its governmentwide administrative responsibilities for PMRS. The manner in which OPM carried out its functions caused confusion and concern among the agencies. In some cases, OPM's written instructions were untimely, unclear, or were different from the PMRS law. (See p. 24.)

**Some Raises Were
Incorrectly Computed**

Despite initial difficulties, agencies made the transition from merit pay to PMRS. Their implementation plans were approved by OPM, and pay increases and performance awards were eventually distributed to employees. However, while the Federal Aviation Administration (FAA) distributed merit increases and performance awards as prescribed by PMRS, the agency incorrectly calculated general pay increases for most of its PMRS employees. Such a mistake caused some employees to become eligible for larger merit increases in future years. (See p. 30.)

Problems Continue to Exist

As with merit pay, the five agencies used PMRS pools to distribute varied amounts of money to deserving employees based on their performance. Yet, factors unrelated to performance which were prevalent under merit pay still exist and can affect the sizes of performance awards received by PMRS employees. Significant differences occurred in award amounts among the agencies for employees with the same grade and rating. (See p. 37.)

Another continuing problem that had existed under merit pay involves the distribution of ratings. Although PMRS prohibits agencies from prescribing ratings distributions, various factors such as budgetary constraints exerted pressure on agencies to influence ratings distributions. (See p. 39.)

**Employees Have Expressed
Concerns About PMRS**

Employees responding to a GAO survey indicated varied levels of understanding of PMRS and its intended benefits. Also, some of the negative perceptions employees had about merit pay—such as mistrust of their performance appraisal systems and concerns that insufficient funds were available to adequately reward performance—appear to have been carried forward to PMRS. (See p. 44.)

Recommendation

GAO recommends that OPM issue guidance to clarify the formula for computing general pay increases so that correct calculations of these increases can be ensured and future incorrect merit increases can be avoided.

GAO is not making any other recommendations at this time because PMRS is a new system and its review covered only the first year's operations. (See p. 41.)

Agency Comments

GAO discussed its findings with agency program officials and included their comments where appropriate. However, GAO did not obtain official agency comments on a draft of this report.

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Abbreviations

BLM	Bureau of Land Management
BOR	Bureau of Reclamation
DOI	Department of the Interior
DOT	Department of Transportation
FAA	Federal Aviation Administration
FPM	Federal Personnel Manual
FS	Fully Successful
GAO	General Accounting Office
GS	General Schedule
HUD	Department of Housing and Urban Development
IRS	Internal Revenue Service
OPM	Office of Personnel Management
PMRS	Performance Management and Recognition System
PSRB	Performance Standards Review Board

Introduction

The merit pay system, which included a cash awards program, was authorized by the Civil Service Reform Act of 1978 (Public Law 95-454, Oct. 13, 1978, 92 Stat. 1179). The system fundamentally changed the manner in which federal supervisors and managers in grades 13 through 15 were paid. No longer did these employees receive the full amount of the annual salary adjustments, within-grade increases, and quality step increases that previously had been available to them as General Schedule employees. Instead, their annual salary adjustments were reduced, and they had to compete for additional merit pay increases based on how well they performed their jobs. These increases were paid out of a fixed merit pay fund which was made up of a maximum of one-half the annual salary adjustment plus an amount equal to the within-grade and quality step increases merit pay employees would have received had they remained under the General Schedule.

The merit pay system was in effect for 3 years (fiscal years 1982 through 1984). During that time the system experienced numerous problems and inequities, many of which were discussed in our report entitled A 2-Year Appraisal of Merit Pay in Three Agencies (GAO/GGD-84-1, March 26, 1984). The report pointed out that a number of nonperformance-related factors influenced the size of merit pay increases awarded to individual employees under merit pay. These included variations in agencies' formulas for distributing merit pay increases and the use of preestablished quotas to determine ratings distributions. In addition, although the Reform Act provided that agencies could use cash awards as an integral part of the merit pay system, some agencies placed more emphasis on their awards programs than did others. Moreover, the lack of full annual salary adjustments and within-grade increases led many employees covered by the system to complain that they were receiving less pay than their counterparts under the General Schedule.

During a floor debate on proposed legislation which was later to change the merit pay system, one Senator succinctly summarized the merit pay situation:

"Everyone agrees: The Senate, the House of Representatives, the administration, merit pay employees and their associations, and this argument is supported by an analysis done by the General Accounting Office. The merit pay system, once a key element in federal personnel management reform, is now widely regarded as poorly implemented, inconsistent, and arbitrary."¹

¹ Congressional Record—Senate, October 10, 1984.

In an attempt to strengthen and improve the pay for performance principles emphasized under merit pay, the Congress enacted the Performance Management and Recognition System (PMRS) which was signed into law on November 8, 1984, as Title II of the Civil Service Retirement Spouse Equity Act of 1984 (Public Law 98-615, 98 Stat. 3195, 3207). Retroactive to October 1, 1984, PMRS is to remain in effect for 5 years, terminating on September 30, 1989.

PMRS reinforced the concept of pay for performance first established under merit pay and continued to rely on performance appraisals as the basis for pay and monetary reward decisions. However, the new system made important changes which sought to address some of merit pay's shortcomings. For example, PMRS established a framework within which employees could receive pay increases that were more comparable with the General Schedule than those provided under merit pay. In addition, PMRS contained provisions designed to help ensure that agencies reward employees for their quality job performance on a more consistent basis.

This report assesses how well PMRS has corrected problems experienced with the merit pay system. In addition, the report discusses the implementation of PMRS, focusing on the steps taken by five selected agencies to make the transition from merit pay to PMRS.

Objective, Scope, and Methodology

The objective of this assignment was to evaluate how selected federal agencies implemented PMRS. This objective included assessing the changes PMRS made to merit pay and examining the role of the Office of Personnel Management (OPM) as the agency responsible for the overall administration of PMRS on a governmentwide basis.

We conducted this assignment at the request of the Chairman, House Committee on Post Office and Civil Service, in coordination with the Chair of the Committee's Subcommittee on Compensation and Employee Benefits, who was our designated contact for this request. As agreed with the requesters, we selected five federal agencies for review. These agencies were selected primarily to provide perspective on how agencies with different sizes of PMRS employee populations implemented the new system. The agencies were

- the Federal Aviation Administration (FAA), a component of the Department of Transportation (DOT);
- the Internal Revenue Service (IRS), a component of the Department of the Treasury (Treasury);

- OPM; and
- two components in the Department of the Interior (DOI)—the Bureau of Land Management (BLM) and the Bureau of Reclamation (BOR).

Our inclusion of these five agencies represents a judgmental selection. Therefore, the results of our work cannot be projected to all federal agencies.

We reviewed the five agencies' PMRS activities in fiscal year 1985—the first year for which PMRS became effective. The fiscal year 1985 merit increases and performance awards paid to PMRS employees in the agencies we visited were based on the employees' 1984 performance appraisals.

According to OPM, on its October 1, 1984, effective date, PMRS covered approximately 122,000 employees, of whom 13,217 were in the five agencies we visited. Table 1.1 shows the total PMRS employee populations in these five agencies.

Table 1.1: PMRS Employee Populations
as of October 1984

Agency	PMRS employees
BLM	550
BOR	670
FAA	5,879
IRS	5,585
OPM	533
Total	13,217

We performed our work at the Washington, D.C., headquarters of the five agencies as well as DOI, DOT, and Treasury. We also visited four field locations in Denver, Colorado, including (1) BLM's Denver Service Center, (2) BOR's Lower Missouri Regional Office, (3) BOR's Engineering and Research Center, and (4) OPM's Denver Regional Office.

To obtain information on OPM's administrative role in implementing PMRS, we reviewed OPM's policies and procedures—including its regulations and guidance—that set forth the PMRS requirements with which federal agencies were expected to comply. We interviewed OPM officials responsible for developing these requirements and for providing guidance and technical assistance to the agencies as they began establishing their internal PMRS policies and procedures. We also reviewed OPM's implementation of PMRS for its own employees.

To obtain information on how the five agencies made the transition from merit pay to PMRS, we

- reviewed how the agencies developed and implemented their performance management and recognition systems;
- examined available statistical information related to PMRS at each agency, such as employees' summary performance ratings, general pay and merit increases, and performance award amounts; and
- asked selected employees about their perceptions of PMRS and its effects on them.

As agreed with the requesters, we did not examine all requirements established by PMRS. For example, because of delays in implementing the cash awards provisions of the law, we did not address this aspect of PMRS during our review. We also did not assess the impact of another PMRS requirement—the establishment in agencies of Performance Standards Review Boards (PSRBs). The purposes of these boards were to (1) assess the appropriateness of performance standards, (2) determine the possible use of group or unit performance awards, and (3) provide technical assistance on demonstration projects related to performance standards. Because PSRBs were not formed or operating in the five agencies until near the completion of our audit work, we did not include them in the review.

In reviewing how the five agencies developed and implemented their systems, we studied the agencies' internal PMRS policies and procedures that were developed to comply with OPM's regulations and guidance. In doing so, we reviewed all available documentation related to PMRS implementation, such as plans, formulas, memoranda, and other relevant documents. We also interviewed agency officials who were responsible for administering PMRS to solicit their opinions on the new system and to obtain additional information on its implementation.

We gathered and examined statistical data on PMRS personnel from four of the five agencies included in our study. The statistical information, which we obtained from computer tapes, covered all PMRS employees at the time the first payments under Title II of Public Law 98-615 became effective. (In the five agencies we studied, the effective date was October 14, 1984.) The data included such items as the employees' equivalent grade levels and positions in the salary ranges; 1984 summary performance ratings; and the amounts of their general pay and merit increases and, where applicable, performance awards. At the time we were conducting our audit work, IRS could not provide us with this

data. However, we obtained summary statistical information from IRS on selected aspects of PMRS, such as the total amount of money IRS spent in fiscal year 1985 on performance awards for PMRS employees.

The four agencies have computer systems containing personnel information which were used to produce the computer tapes we required. We verified the accuracy of the data provided to us by comparing the computerized records for random samples of employees from Washington, D.C., and Denver to the supporting hard copy documents in the employees' official personnel folders and/or employees' performance files. The specific information we verified included

- the employee's summary performance rating;
- the employee's equivalent grade level and position in the salary range; and
- the amount of money (i.e., general pay and merit increases and performance award) the employee received.

This verification procedure showed that, based on our samples of employee records, the four agencies' computer systems contained reasonably accurate information (i.e., error rates for all data elements checked ranged from 0 at BLM to .96 percent at FAA.)

Using statistical computer programs, we conducted a series of analyses to examine the distributions of employees' ratings in the agencies we visited and the amounts of money they received based on their 1984 performance. Also, to obtain indications of how employees viewed PMRS, we gathered information from a total of 634 PMRS employees and 234 supervisors of PMRS employees at the headquarters and selected field locations of the five agencies. We used a standard set of questions to obtain information on various aspects of PMRS from these individuals. Because of the manner in which the individuals were selected, which is described in detail in appendix III, their views cannot be assumed to be representative of all PMRS employees and supervisors governmentwide nor of all PMRS employees and supervisors in the locations or agencies we visited. Nevertheless, we believe this work provided us with a more informed perspective on the initial feelings of those directly affected by PMRS.

We conducted our work between February 1985 and August 1986. During the assignment, we discussed the results of our work with responsible agency program officials at the five agencies and included their comments where appropriate. However, as requested, we did not

obtain official agency comments on a draft of this report. Otherwise, our work was performed in accordance with generally accepted government auditing standards.

PMRS Attempted to Correct Problems Experienced Under Merit Pay

PMRS included various provisions which made substantive changes to the way the merit pay system operated. Generally, these provisions sought to produce a more workable and equitable pay for performance system by correcting problems experienced under merit pay.

PMRS' Standardized Formula Provided for More Uniform and Equitable Salary Increases

Employees under the merit pay system were guaranteed one-half the average annual salary adjustment that was paid to General Schedule employees. The funds that would have been used for the other half of the annual adjustment were used to partially fund merit pay increases. Merit pay increases were also funded by the money that would have been used to pay within-grade and quality step increases if merit pay employees had remained under the General Schedule.

Each agency devised its own formula for computing merit pay increase amounts. The formulas included such variables as performance salary ceilings, which limited the total salary employees with given levels of performance in each grade could receive and acceleration factors, which awarded larger increases to employees lower in the salary range. Because of the many possible variations that could be incorporated into the formulas, the merit pay increases each agency paid could vary significantly among agencies for employees with similar performance ratings.

In contrast, PMRS guarantees employees who are rated fully successful or higher a general pay increase which is the equivalent of the full annual salary adjustment granted to General Schedule employees. Moreover, depending on their performance ratings, these employees are guaranteed all or part of a merit increase each year. A full merit increase equals a within-grade increase under the General Schedule.

PMRS provides for five standard summary performance rating levels—a fully successful level, two levels above fully successful, and two levels below. As shown in table 2.1, the amounts of PMRS merit increases are determined by employees' performance ratings for the year and their positions in the salary range for their grade. The exception to these increases applies to employees who are at or near the maximum rate of their salary range. Employees cannot receive a merit increase that would cause their salaries to exceed the maximum rate for their grade. The same limitation existed under merit pay and still exists in the General Schedule.

Table 2.1: Merit Increases Under PMRS

Rating	Lower third of salary range	Upper two-thirds of salary range	At maximum rate
Two levels above fully successful	Full merit increase	Full merit increase ^a	No merit increase
One level above fully successful	Full merit increase	One-half merit ^a increase	No merit increase
Fully successful	Full merit increase	One-third merit ^a increase	No merit increase

^aResulting salary cannot exceed maximum rate for the grade.

By providing employees with pay increases similar to those under the General Schedule, PMRS can reduce the likelihood that an employee rated fully successful or better would be monetarily penalized. Under merit pay, employees rated fully successful or better often had their salaries fall below the levels they would have attained under the General Schedule. As discussed previously, a reason for this occurrence was that agencies relied on different formulas for computing merit pay increases. (See p. 16.) PMRS eliminated the need for agencies to use such formulas by prescribing the specific merit increase amounts employees would receive based on their performance ratings and positions in the salary range.

Another objective of PMRS, not specified under merit pay, was to reduce or withhold pay increases for less than fully successful performance. Under PMRS, employees rated one level below fully successful receive one-half the general pay increase and no merit increase while employees rated two levels below fully successful receive neither.

PMRS Changed Merit Pay's Monetary Awards System

Under PMRS, employees are eligible to receive two types of awards—performance awards and cash awards. PMRS performance awards are used to reward employees for the quality of their job-related performance as reflected in their performance appraisals. PMRS cash awards call for employees to receive one-time cash payments for suggestions, inventions, superior accomplishments, or other personal efforts similar to merit pay's cash awards. However, the emphasis on cash awards under PMRS has changed. Under merit pay, cash awards were generally used for rewarding job-related performance. Now, PMRS performance awards are used to reward employees for their job-related performance, and PMRS cash awards are to be used for specific acts or achievements above and beyond regular performance.

PMRS Requires Agencies to Give Performance Awards

As discussed in our previous report, the merit pay system contained a cash awards program which was designed to reward employees for outstanding performance. However, OPM had not ensured that agencies were using cash awards as an integral part of merit pay. Thus, some agencies placed more emphasis on their awards programs than others.

In our merit pay report, for example, we pointed out that Navy gave 15 percent of its merit pay employees cash awards averaging about \$2,700 in 1981. In 1982, Navy restricted the dollar amount of cash awards to 1 percent of basic salaries of merit pay employees in each unit, and awards averaging \$1,100 were given to 31 percent of its merit pay employees. On the other hand, in each year, the Departments of Agriculture and Housing and Urban Development (HUD) gave cash awards to 6 percent of their merit pay employees averaging \$1,000 at Agriculture and \$500 at HUD.

PMRS is intended to ensure that agencies more consistently recognize employees for quality performance through the use of performance awards. Under PMRS, agencies are required to spend a specified minimum amount of funds to grant employees such awards. The minimum amount is scheduled to rise from 0.75 percent of the estimated aggregate amount of PMRS employees' basic pay for fiscal year 1985 to 1.15 percent for fiscal year 1989. The minimum amounts for the intervening years are to be adjusted incrementally in accordance with regulations issued by OPM. For fiscal year 1986, OPM set the minimum at 0.85 percent. The PMRS legislation also established a maximum amount of 1.5 percent of aggregate PMRS salaries that can be paid for performance awards to be used in each of the 5 years for which PMRS was authorized.

A PMRS employee with a summary rating two levels above fully successful must be given a performance award by his or her agency and, after fiscal year 1985, the award must be at least 2 percent of the employee's annual rate of basic pay.¹ Individual employees may receive performance awards of up to 10 percent of their annual rate of basic pay. Moreover, the performance award paid to an employee rated two levels above fully successful may go as high as 20 percent of basic pay if the agency determines it is warranted by unusually outstanding performance. Employees rated fully successful or one level above fully successful are also eligible to receive performance awards, but such awards are to be granted at the discretion of each agency.

¹In fiscal year 1985, no minimum award amount was required.

PMRS Retains Cash Awards

As under merit pay, cash awards of up to \$10,000 can be given to PMRS employees by the agency head. If the agency receives OPM approval, this maximum can be increased to \$25,000. Also, the President may pay a cash award to any PMRS employee in addition to the agency cash award.

In its communications to agencies on PMRS cash awards, OPM has stipulated that they are to be given for contributions that are unique, highly exceptional, and unusually outstanding and beyond normal job responsibilities and performance standards. Examples of the types of acts that OPM deems worthy of a PMRS cash award include:

- direct input into shifts of major policy;
- solutions to major management problems, such as significantly improving the procedures for processing claims; and
- significant new developments, such as discovering the cure for cancer.

Not surprisingly, given accomplishments of this suggested magnitude and the fact that a performance awards program exists under PMRS, OPM officials expect the cash awards program to be used less frequently than it was under merit pay.

PMRS Corrected Many of the Problems With Merit Pay Pools

Under merit pay, employees were placed in organizational groups, called merit pay pools, whose composition was determined by agency management. A major criticism of the merit pay system was the degree to which factors unrelated to performance, such as the distribution of ratings within merit pay pools and the grades and salaries of pool members, influenced the amount of merit pay that the individuals in the pool received.

The distribution of ratings within a merit pay pool was crucial in determining each employee's merit pay increase. As a result, employees in different pools could receive significantly different increases even if they received comparable ratings.

In our study of merit pay, we found significantly greater merit pay increases given to merit pay employees in pools with fewer high level ratings than were given to equally graded and rated employees in pools with more high level ratings. For example, in 1982 at HUD, a GM-14 employee rated at HUD's highest rating level in one pool received over \$1,200 more in merit pay than a similarly rated counterpart in a second pool. In the former case, only 4 percent of the ratings in the pool were at

the highest rating level, while in the latter case, 18 percent were. Additionally, in 1981, employees in one HUD pool received larger merit pay increases than employees with higher ratings in another pool. Again, these differences were affected by the distribution of ratings in the respective pools.

In addition, the combination of pool members' grades and positions in the salary range affected the amount of money included in, and the individual merit pay increases made from, each merit pay pool fund. OPM's merit pay formula required different amounts to be included in each pool fund for GM-13s, -14s, and -15s at different positions in the salary range. Therefore, the total funds could vary depending on the number and combination of grades and salaries in each pool.

As discussed previously, pay increases for each level of performance under PMRS are specified in the law. Thus, the nonperformance-related factors which influenced the size of employees' merit pay increases do not affect the amounts of pay increases under PMRS. Instead, these increases are based solely on the employees' performance ratings and their positions in the salary range.

However, PMRS did not completely eliminate the adverse effects of the merit pay pool concept. Agencies still retain the option to use organizational groups (i.e., pools) in granting performance awards. When this happens, nonperformance-related factors can affect the amounts of individual employees' performance awards in the same ways such factors affected individual merit pay increases within merit pay pools. This matter is discussed in more detail in chapter 4.

PMRS Prohibits Prescribed Distribution of Ratings

Although OPM's merit pay regulations prohibited the use of preestablished or forced distribution of ratings for merit pay employees, there was no such provision in the merit pay legislation. The reasons for OPM's regulatory prohibition under merit pay were stated in a 1979 OPM pamphlet:

"To allow artificial and arbitrary non-performance factors to drive the merit pay increase would . . . do irreparable harm to the Merit Pay System."²

²Your Merit Pay System, OPM, November 1979, p. 26.

Despite this prohibition, we found documented evidence in our study of merit pay that management at Agriculture and HUD had used preestablished quotas to determine ratings distributions for their merit pay pools. In addition, many employees responding to our attitude survey in these two agencies, as well as in Navy, believed that management used quotas to develop ratings. Moreover, respondents who believed management used a quota system in developing ratings generally had negative feelings toward the merit pay system.

PMRS legislatively reinforced the former regulatory prohibition against a prescribed distribution of ratings. PMRS provides that neither OPM nor any other agency may prescribe a distribution of levels of performance ratings for PMRS employees. However, several other forces, both internal and external to PMRS, may continue to exert pressure on the agencies to, in some way, control or influence the distribution of ratings for PMRS employees. A more detailed discussion of this issue is in chapter 4.

PMRS Requires Written Communication of Standards and Employee Involvement in Setting Them

The Reform Act required agencies to encourage employee participation during the performance standard-setting process and to communicate performance standards to employees at the beginning of each appraisal period. These provisions applied to merit pay employees as well as other civil service employees. Performance standards provide the criteria for evaluating an employee's performance of specific tasks. The standards enable supervisors and employees to determine how well employees are doing their work by comparing their actual performance to established criteria.

In our study of merit pay, most employees responding to our questionnaire believed their standards were fair, tailored to their jobs, and consistent with organizational goals. However, many employees in the merit pay pools we reviewed did not receive their standards at the beginning of their appraisal period. Moreover, many employees responding to our questionnaire were not satisfied with the amount of input they had in setting their standards.

PMRS added new requirements to the standard-setting process. The new system requires supervisors and employees to jointly develop performance standards. In addition, agencies must communicate in writing to each PMRS employee the performance standards and critical elements of his or her position at the beginning of each appraisal period. PMRS also requires that a Performance Standards Review Board be established in each agency to assess the appropriateness of the agency's performance

standards and to provide technical assistance on demonstration projects related to performance standards.

According to a study conducted for OPM,³ performance standards developed jointly by supervisors and employees tend to result in greater employee acceptance of the standards, more positive employee attitudes, and, possibly, higher quality standards. In addition, our merit pay study showed that employees who were satisfied to a great or very great extent with the input they had in setting standards were more positive about the fairness of the merit pay/performance appraisal process than employees who did not have a great deal of involvement in the standard-setting process.

³Organizational Assessments of the Effects of Civil Service Reform, Case Western Reserve University, Fall 1982.

From Merit Pay to PMRS: A Difficult Transition

Both OPM and the agencies were faced with implementing the numerous changes contained in PMRS in an extremely short period of time. Because PMRS was enacted on November 8, 1984, but was effective retroactively to October 1, 1984, OPM and the agencies had to plan for and implement the system simultaneously.

Lacking adequate lead time, the five agencies we reviewed were confronted with administrative problems beyond those normally posed by the transition to a new system. Complicating this situation was the fact that OPM, faced with time constraints itself, did not always issue guidance and regulations in a timely fashion. In addition, the guidance and regulations were sometimes confusing and inconsistent with respect to requirements or stipulations in the law.

The Inability to Prepare for PMRS Contributed to Administrative Difficulties for Agencies

Because PMRS was retroactive to October 1, 1984, federal agencies had no time preceding its effective date to adequately prepare for its implementation. The lack of sufficient start-up time in the five agencies we visited contributed to several administrative problems in the transition from merit pay to PMRS.

The five agencies we visited did not have sufficient time and information to train and inform PMRS employees and their supervisors about the new system before implementing it. At one agency, employees we surveyed in September 1985 were under the impression that PMRS would not become effective until October 1985, even though they had already received payments under PMRS.

The retroactive implementation of the law did not provide agencies with lead time to make decisions on the amounts of performance awards to be distributed among employees. Thus, performance awards made in the five agencies in the transition year were not always paid in a timely manner. In some cases, performance awards were received by employees many months after the performance period for which they were being rewarded. In the agencies we visited, the awards followed the period of performance by between 2 and 9 months, as shown in table 3.1.

Table 3.1: Timing of Performance Awards Given in Fiscal Year 1985 in Selected Agencies

Agency	End of performance appraisal period	Month-year performance awards were given	Number of months by which performance awards followed appraisal period
BLM	9-30-84	4-85	6
BOR	6-30-84	4-85	9
FAA	6-30-84	2-85	7
IRS	9-30-84	12-84	2
OPM	9-30-84	2-85	4

Because performance awards are intended to provide an incentive for better performance, their timely payment is preferable. The longer the interval of time between the performance being rewarded and the reward, the weaker the link between the reward and the specific performance. OPM has endorsed the timely payment of performance awards and encourages agencies to pay performance awards as close to the end of the appraisal period as they deem practicable.

OPM Issued Regulations and Guidance on a Piecemeal Basis

PMRS required OPM to prescribe regulations to federal agencies for implementing the new system. To meet this requirement, OPM published interim and final regulations, as well as guidance in bulletins issued through the Federal Personnel Manual (FPM) system. Because of the lack of lead time to implement PMRS, OPM's initial guidance and regulations were issued over a period of months.

On October 12, 1984, OPM sent a letter to federal personnel directors advising them of the impending PMRS legislation. The letter provided initial guidance to agencies on what actions they would need to take, assuming PMRS became law. This was the first formal notification of PMRS that agencies had received from OPM. Throughout the implementation period, OPM also issued several FPM bulletins to the agencies with additional guidance on selected aspects of PMRS implementation.

Despite a statement in the October 12, 1984, letter that OPM would issue regulations to implement the new law in the "near future," interim regulations on PMRS did not appear in the Federal Register until March 25, 1985—almost 6 months after the effective date of the law. Moreover, OPM's final regulations on PMRS were not published until August 30, 1985.

One OPM official attributed the extended time frames for issuing regulations and guidance to the fact that PMRS was made retroactively effective. He added that OPM had to spend a great deal of its time and resources resolving technical problems and responding to questions that agencies had about PMRS. He also said that since the system was being implemented simultaneously with the setting of PMRS policy, agencies had to resort to calling OPM for the answers they needed. According to this official, OPM received hundreds of telephone calls which had to be handled by a limited number of OPM staff.

In addition to information which clarified or explained PMRS provisions, OPM regulations and guidance contained detailed technical instructions for agencies to follow in implementing the law. In some cases, the OPM instructions were unclear or were issued too late for agencies to easily apply them.

For example, OPM's March 25, 1985, issuance of the interim regulations illustrates how untimely the guidance was. The regulations initially required agencies' comprehensive PMRS performance management plans to be submitted, approved, and implemented at least 120 days before the end of agencies' performance appraisal periods. This requirement was meant to ensure that PMRS employees were covered by the new plans' performance elements and standards for a 90-day minimum appraisal period. Because OPM's regulations were not issued until March 25, not all the agencies we visited were able to meet the original requirements regarding plan implementation. BOR and FAA did not have sufficient time to fulfill this requirement because their appraisal periods ended on June 30, 1985. Given the 120-day requirement, the other three agencies whose appraisal periods ended on September 30, 1985, had slightly more than 60 days to write, submit, obtain approval of, and implement the comprehensive plans. OPM recognized that agencies would be unable to adhere to its original scheme. On April 4, 1985, OPM extended the time frames and provided for reapproval of agencies' current performance appraisal plans which all five agencies eventually obtained.

In another example, an FPM bulletin dated December 11, 1984, contained new guidance from OPM pertaining to employees who entered PMRS on or before the effective date of the merit increase. The guidance stated that employees who had received another basic pay increase such as a within-grade increase or a promotion within the preceding 90 days would not receive merit increases. This was the first guidance sent to agencies with such a provision. However, OPM had also set a deadline

that required merit increases to be paid no later than December 31, 1984. Given this deadline, DOI had begun to process its merit increases for its components, including BLM and BOR, before OPM issued its guidance. Because of this, OPM informed DOI that the 90-day rule would not apply to any DOI employees who were in the affected category. Thus, all PMRS employees at BLM and BOR received merit increases, regardless of whether they had recently received other basic pay increases.¹

In another case, on January 10, 1985—4 days after the general pay increase for PMRS employees became effective—OPM issued guidance on how the general pay increase should be calculated. The prescribed method was materially different from the one used by IRS. In response, IRS had to reprogram its payroll changes which revised PMRS employees' annual salary amounts on the average of \$2 to \$3 each.

In addition, the initial OPM guidance of October 12, 1984, was unclear. It contained the following instructions which related to determining merit increases for employees who, for various reasons, did not have current performance appraisals: "The employee's rating of record is extended and the appropriate increase is granted, if that rating was given in the previous rating period. . ." The term "previous rating period" was not defined. An internal DOI memorandum prepared to comply with the guidance stated: "The [DOI PMRS] Committee had decided that 'the previous rating period' as used in available OPM guidance should be defined as FY 84. To confirm this construction, we called OPM and were advised that FY 83 is to be used. Accordingly, we have made changes in the attached draft." This lack of clarity caused greater problems at FAA, which made the same initial assumption as DOI, but did not learn of OPM's intention until after merit increases had been made. FAA then had to adjust the merit increases for some of its employees.

OPM did not provide in writing its requirement for agencies to specify in their performance management plans that fully successful employees be eligible for performance awards. According to an OPM official, this requirement did not appear in any guidance or regulations but was imposed through the plan approval process. He explained that if an

¹A recent Comptroller General decision (B-219290; Sept. 26, 1986) addressed a situation at the National Aeronautics and Space Administration (NASA) which appeared similar to the DOI situation. The decision stated that, in accordance with OPM regulations, 22 NASA employees who received merit increases in October 1984 were not entitled to them because the employees had received basic pay increases within 90 days preceding the effective date of the merit increase.

agency submitted a performance management plan to OPM without a specific provision that fully successful PMRS employees were eligible for performance awards, OPM would send the plan back and ask that the relevant provision be included. According to a DOR official, the agency was informed of the OPM requirement after submitting its plan. This occurrence caused difficulties for DOR and its components because DOR originally required the elimination of performance award eligibility for fully successful employees from the components' plans.

The PMRS statute gave OPM responsibility for setting, within a specified range, the minimum percentage of aggregate base pay to be used by agencies for performance awards each year. OPM provided the information after the agencies needed it. OPM issued the final rule on the minimum funding level for fiscal year 1986 on December 27, 1985—almost 3 months after the fiscal year began. An OPM official believed that the delay was due to OPM's internal review process.

OPM Issued Regulations and Guidance on Performance Awards That Varied From the Law

PMRS guidance issued by OPM in an FPM bulletin dated November 29, 1984, stated that PMRS employees rated one level above fully successful must be paid a performance award. However, the PMRS statute stated that employees rated one level above fully successful may be paid a performance award. OPM subsequently changed the word "must" contained in the guidance to the word "should" in its interim PMRS regulations issued on March 25, 1985.

In fiscal year 1985, the four agencies from which we obtained statistical data gave performance awards to all employees rated one level above fully successful. An agency official advised us that IRS also granted such awards to all employees rated one level above fully successful. Three of the five agencies paid their performance awards by March 25, 1985, and two were very close to doing so. Documents at four of the five agencies attributed the decisions to give performance awards to these PMRS employees to the mandatory language contained in the OPM guidance, despite the discretionary language contained in the PMRS law. For example, an internal memorandum at DOI stated:

"OPM has gone further [than the law] in also mandating monetary awards for [one level] above fully successful (Level II) performers. . . ."

"The major problem of performance awards under the new system is that earlier budget estimates have not anticipated such outlays. Thus, left to our own devices, we would be disposed to provide performance awards only for Level I ratings [two

levels above fully successful] as required by the law to minimize this year's expenditure."

In response to our inquiries on this matter, OPM explained that its purpose in using "must" in the initial guidance was "... to fully implement a pay for performance system by requiring that employees receive greater rewards for successively higher levels of performance." However, OPM acknowledged that this requirement could not be supported by the language in the PMRS law. Thus, in its subsequent regulations, OPM included the term "should" to convey to the agencies its belief that employees who perform above the fully successful level deserve the recognition of performance awards. OPM has stated that this language does not limit the discretion of agency heads to decline to grant performance awards to employees who were rated one level above fully successful.

Officials at DOI, DOT, and Treasury expressed dissatisfaction with this OPM requirement in its initial guidance because it was not statutorily mandated and was the cause of budgetary concerns. However, the officials told us that since OPM changed its "must" guidance to a "should" regulation, their concern was alleviated. The officials added that, insofar as it is possible given budgetary constraints, they endorse the philosophy of granting performance awards to all PMRS employees who perform above the fully successful level to recognize them for their quality job performance.

Conclusions

As agencies proceeded to implement changes to their merit pay systems as mandated by PMRS, they encountered a variety of administrative difficulties. In some respects, OPM's guidance and regulations establishing PMRS made the implementation of this new system more difficult.

Agencies Implemented PMRS, but Problems Continue to Exist

Despite the difficulties encountered in making the transition to PMRS, three of the four agencies from which we obtained individual personnel data made pay changes and granted performance awards as required under the new law.¹ The fourth agency—FAA—provided merit increases and performance awards as stipulated by the PMRS legislation. However, the agency miscalculated general pay increases for many of its PMRS employees which could affect the amounts of some employees' future merit increases.

We also found that the amounts of employees' performance awards varied greatly, both among and within the four agencies, for employees with the same grade and rating. These differences were attributable to factors other than performance. Moreover, although PMRS prohibits agencies from prescribing how ratings will be distributed, some pressures to control ratings distributions within agencies remain.

Most Basic Pay Changes Were Made in Accordance With the Law

The PMRS legislation required merit increases to be effective for the first full pay period of fiscal year 1985. In the four agencies, the first full pay period began on October 14, 1984. Because the law was signed in November 1984 and agencies needed time to implement this provision, the merit increases had to be granted retroactively. The fiscal year 1985 general pay increase of 3.5 percent for PMRS employees was effective in January 1985. Tables 4.1 and 4.2 show the pay increases required under PMRS in fiscal year 1985.

Table 4.1: Required PMRS Merit Increases in Fiscal Year 1985*

Grade	Rating/location in pay range					
	Two levels above fully successful		One level above fully successful		Fully successful	
			Location in pay range		Location in pay range	
	Location in pay range					
	Lower 1/3	Upper 2/3	Lower 1/3	Upper 2/3	Lower 1/3	Upper 2/3
GM-15	\$1,683	\$1,683	\$1,683	\$842	\$1,683	\$561
GM-14	1,431	1,431	1,431	716	1,431	\$477
GM-13	1,211	1,211	1,211	606	1,211	\$404

*For various reasons, not all employees were eligible to receive these merit increase amounts. For example, employees at or near the maximum rate for their grade cannot receive a merit increase that puts their salaries above that rate.

¹As mentioned in chapter 1, IRS could not provide the personnel data necessary for most of the analysis included in this chapter.

**Table 4.2: Required PMRS General Pay
Increases in Fiscal Year 1985**

Grade	Fully successful and above (range) ^a	One level below fully successful (range) ^a
GM-15	\$1,767 – \$2,298	\$884 – \$1,149
GM-14	1,502 – 1,952	751 – 976
GM-13	1,272 – 1,650	636 – 825

^aThe amount of the general pay increase varied within a grade based on an employee's relative position in the pay range.

Three of the four agencies granted the fiscal year 1985 pay increases required by PMRS, as shown in tables 4.1 and 4.2. Merit increases for FAA employees were also paid as specified by PMRS. However, about 4,000 FAA employees received annual salaries of \$1 to \$3 less than they should have because FAA miscalculated their general pay increases. According to DOT and FAA officials, general pay increases were also miscalculated in the same manner DOT-wide. This resulted in DOT providing approximately 7,000 employees with incorrectly calculated general pay increases, including the 4,000 FAA employees.

OPM's formula for calculating the general pay increase did not specify the degree of precision (i.e., the exact number of decimal places) needed to assure that employees would receive the correct salaries. In applying the formula, DOT and FAA used an insufficient number of decimal places to arrive at the proper salary amounts. Also, DOT and FAA did not round employees' salaries in accordance with OPM regulations. These errors resulted in \$1 to \$3 salary shortfalls in the FAA calculations.

By receiving a general pay increase that was \$1 to \$3 less than what they should have received, 228 FAA employees were repositioned in the lower third of their salary range, and thus became eligible for larger merit increases in the following year. As shown in table 4.3, depending on these employees' ratings at the end of the following appraisal period, their fiscal year 1986 merit increases could be as much as three times what they would have been if the correct general pay increase had been given.

Table 4.3: Effects of Incorrect Fiscal Year 1985 General Pay Increases Paid by FAA on Fiscal Year 1986 Merit Increases

Grade (GS step 4 salary) ^a	Salary as calculated by FAA	If 1985 rating was:	Then FY 86 merit increase would be:	With correct general pay increase, merit increase would have been:
GM-13 (\$41,358)	\$41,357	2 levels above FS ^b	\$1,253	\$1,253
		1 level above FS ^b	1,253	627
		FS ^b	1,253	418
GM-14 (\$48,873)	48,872	2 levels above FS ^b	\$1,481	\$1,481
		1 level above FS ^b	1,481	741
		FS ^b	1,481	494
GM-15 (\$57,488)	57,487	2 levels above FS ^b	\$1,742	\$1,742
		1 level above FS ^b	1,742	871
		FS ^b	1,742	581

^aThese salary figures were the appropriate basic pay rates for employees at the step 4 level after the 1985 general pay increase became effective.

^bFS—fully successful.

According to DOT and FAA officials, 189 DOT employees, including 173 FAA employees, actually received 1986 merit increases exceeding what they should have been. If not corrected, the 1985 calculations could continue to affect certain PMRS employees' future merit increases. DOT and FAA officials advised us that the miscalculated salaries would be corrected and the formula changed so that future general pay increases will be computed correctly. We discussed our finding with OPM officials who assisted DOT and FAA officials in resolving this matter. Also, OPM officials agreed that issuing additional guidance to clarify OPM's formula would be a reasonable course of action. At the conclusion of our review, OPM officials informed us that they were in the process of developing such guidance.

As required by PMRS, employees rated below fully successful at the four agencies received no merit increases. In addition, employees rated one level below fully successful received one-half the general pay increase, and employees rated two levels below fully successful did not receive general pay increases. The number and percent of employees at each of the four agencies rated below fully successful are shown in table 4.4.

Table 4.4: PMRS Employees at Selected Agencies Rated Below Fully Successful for Fiscal Year 1984 Performance

Agency	GM-13		GM-14		GM-15		Total	
	No.	Percent of GM-13s	No.	Percent of GM-14s	No.	Percent of GM-15s	No.	Percent of all PMRS employees
BLM	0	•	1	0.5	0	•	1	0.2
BOR	4	1.1	1	0.4	0	•	5	0.7
FAA	7	0.4	4	0.2	9	0.4	20	0.3
OPM	6	2.7	3	1.7	5	4.1	14	2.7

Comparison of PMRS Pay Increases to General Schedule Increases

A major concern with the merit pay system was that merit pay employees with ratings of fully successful or better often had their salaries fall below the levels they would have attained had they received the annual salary adjustments and within-grade increases under the General Schedule. Because PMRS was designed in part to address this concern, we analyzed the relative positions of the PMRS employees rated fully successful or better in the four agencies as measured against the General Schedule.

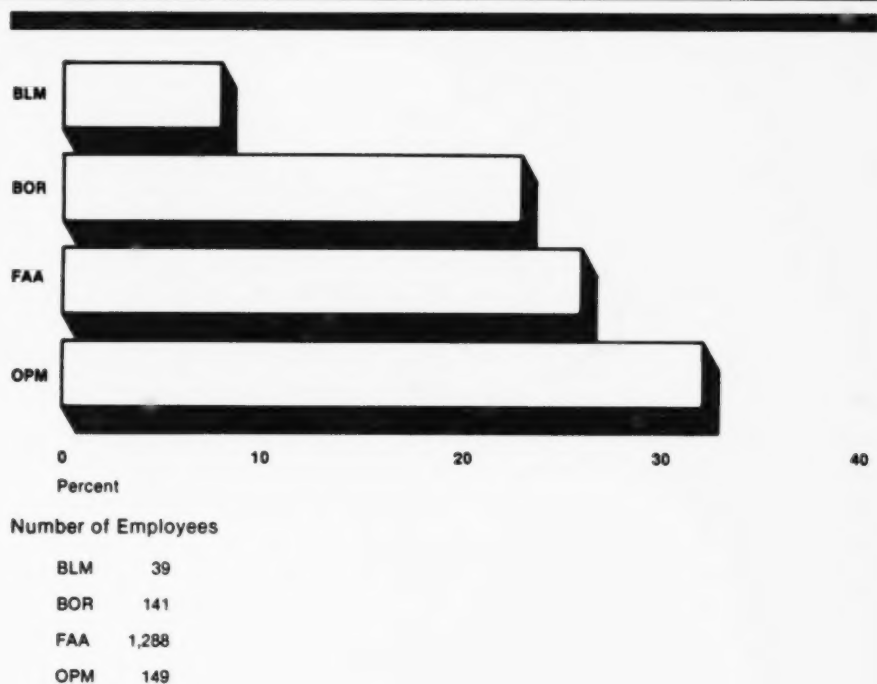
As discussed in chapter 1, the merit pay system guaranteed employees only one-half of the annual salary adjustment received by General Schedule employees. Merit pay employees had to compete with each other for additional pay increases. PMRS insures that fully successful or better employees receive full annual salary adjustments in the form of general pay increases, as well as all or part of the equivalent of within-grade increases, in the form of merit increases.

Most PMRS employees are eligible for merit increases that are equivalent to or greater than the within-grade increases received by their General Schedule counterparts. We determined that the number of PMRS employees who received such increases at the four agencies ranged from 68 percent at OPM to 92 percent at BLM.

The only PMRS employees who do not receive merit increases at least equivalent to General Schedule within-grade increases are employees rated fully successful with salaries in the middle third of their pay range (equivalent to General Schedule steps 4 through 6). These employees are eligible for merit increases amounting to one-third of a within-grade increase each year. In comparison, fully successful employees in steps 4 through 6 of the General Schedule receive full within-grade increases every 2 years. Although PMRS employees can

improve their performance and become eligible to receive larger merit increases in subsequent years, we determined that this group of PMRS employees were at a relative disadvantage compared to General Schedule employees. The disadvantage exists because General Schedule employees in steps 4 through 6 would receive full within-grade increases every 2 years, but it would take comparable PMRS employees 3 years to receive increases totalling full within-grade increases. The percentages of PMRS employees in the four agencies in this category are shown in figure 4.1.

Figure 4.1: Percentage of Selected Agencies' PMRS Employees in the Middle Third of the Pay Range Rated Fully Successful for 1984



Because of the relative disadvantage discussed above, we looked at how many of these employees received performance awards, which could have helped to alleviate this disadvantage. OPM was the only one of the four agencies at which fully successful employees who were in the middle third of their pay range received performance awards. As indicated in figure 4.1, at OPM, 149 employees who were in the middle third of their pay range were rated fully successful for the 1984 performance appraisal period. Forty of these employees (about 27 percent) received

performance awards. The average amounts of these awards were \$368 for a GM-13, \$462 for a GM-14, and \$530 for a GM-15.

Performance Awards Were Paid as Required, but Nonperformance Factors Caused Amounts to Vary Widely

In addition to general pay and merit increases, PMRS provides for performance awards as an integral part of the compensation available to covered employees. Although performance awards are considered to be bonuses, not additions to basic pay, the law guarantees them to individuals in the top performance category and requires agencies to spend a specified minimum amount on these awards each year. Under the merit pay system, cash awards designed to reward employees for outstanding performance were not widely used, and there were no guarantees as to who would receive cash awards in the agencies where they were given.

Performance Award Expenditures in Fiscal Year 1985

As discussed in chapter 2, PMRS required agencies to spend a minimum of 0.75 percent and a maximum of 1.5 percent of the PMRS employees' estimated aggregate basic pay in fiscal year 1985 for PMRS performance awards. Table 4.5 shows the amounts spent on performance awards by the five agencies in fiscal year 1985. In these agencies, all of these funds were used to reward 1984 performance.

Table 4.5: Amounts Spent on Performance Awards in Fiscal Year 1985 in Selected Agencies^a

Agency	Percent of aggregate basic pay	Dollars
BLM	1.03	\$284,959
BOR	1.49	482,526
FAA	1.56 ^b	4,657,373
IRS	1.36	3,442,888
OPM	1.45	388,359

^aInformation contained in this table was obtained from agency reports submitted to OPM.

^bThe maximum allowable percentage for performance awards is 1.5 percent. We were advised by OPM that the 1.5 percent ceiling applies to executive agencies, such as DOT. Since FAA is a component of DOT, the expenditures reported by FAA must be combined with the expenditures of DOT's other components before a determination can be made as to whether the statutory limitations have been exceeded. In fiscal year 1985, DOT's reported expenditure percentage was 1.4 percent.

All PMRS employees at BLM, BOR, and OPM rated two levels above fully successful received performance awards in fiscal year 1985 as required by law. At FAA, all but 4 of the 833 PMRS employees rated at the top level received awards for performance. FAA officials could not provide an explanation as to why these four employees were excluded. All but one

of the employees at the four agencies rated one level above fully successful received performance awards in fiscal year 1985, as originally required by OPM in its November 29, 1984, guidance. (See p. 28.) Thus, PMRS employees, when rated above fully successful, were generally rewarded with money in addition to any permanent pay increases they may have received. OPM also gave performance awards to 30 percent of its employees rated at the fully successful level. The other three agencies did not give performance awards to employees with fully successful ratings.

Individual award amounts varied considerably within the agencies. Tables 4.6 and 4.7 show the ranges of performance awards by grade and rating at the four agencies for employees rated above fully successful.

Table 4.6: Ranges of Fiscal Year 1985 Performance Awards for Employees Rated Two Levels Above Fully Successful in Selected Agencies

Agency	GM-13		GM-14		GM-15	
	Low	High	Low	High	Low	High
BLM	\$727	\$985	\$859	\$1,116	\$1,016	\$1,280
BOR	722	3,178	2,815	3,736	3,282	4,286
FAA	471	4,349	73	4,865	86	6,040
OPM	1,229	3,483	2,606	4,381	1,785	6,118

Table 4.7: Ranges of Fiscal Year 1985 Performance Awards for Employees Rated One Level Above Fully Successful in Selected Agencies

Agency	GM-13		GM-14		GM-15	
	Low	High	Low	High	Low	High
BLM	\$363	\$493	\$429	\$588	\$505	\$650
BOR	790	1,290	1,073	1,504	1,314	1,750
FAA	235	2,174	278	2,666	327	3,020
OPM	465	1,763	1,059	2,232	1,281	2,541

OPM was the only one of the four agencies that gave performance awards to employees rated at the fully successful level in fiscal year 1985. Performance awards for these employees ranged from: \$131 to \$472 for GM-13s; \$170 to \$588 for GM-14s; and \$150 to \$656 for GM-15s.

Nonperformance-Related Factors Influenced Performance Awards

As discussed in chapter 2, an agency may use pools to grant performance awards. The distributions of ratings within such pools is one nonperformance-related factor that affects the amount of money available for performance awards.

Typically, agencies use a percentage of PMRS employees' aggregate salaries for the total amount of money to be used for PMRS pay increases and

performance awards. For the 1984 performance period, OPM required that agencies' total payments (including general pay increases, merit increases, and performance awards) be within the range of 5.7 to 5.9 percent of the aggregate amount of PMRS employees' basic pay. Since general pay and merit increases are required to be paid first, the amount of money available for performance awards depends upon how much remains after these increases have been paid. If ratings in a pool are high, a greater amount of the pool's available funds must be used for merit increases. Thus, less money would be available for performance awards.

At DOI, for example, the 5.7 to 5.9 percentage range for total PMRS payments was established for all pools. BLM and BOR constituted separate pools and, as shown in table 4.8, BLM's ratings distribution was higher than BOR's. Because of the higher ratings, BLM was required to spend more than BOR on merit increases which left it with less money available for performance awards than BOR. In fiscal year 1985, BLM spent about 1 percent of its PMRS payroll on performance awards, whereas BOR spent about 1.5 percent.

Table 4.8: Percentage of 1984 Ratings
Distributions at BLM and BOR

Agency	Rating levels			
	Below fully successful	Fully successful	One level above fully successful	Two levels above fully successful
BLM	0.2	18.0	64.2	17.6
BOR	0.7	47.5	46.3	5.5

As shown in appendix II, higher-graded PMRS employees at the agencies we reviewed generally received higher ratings than lower-graded PMRS employees. When this happens, pools with a larger proportion of higher-graded employees will have less money available for performance awards than pools with a larger proportion of lower-graded employees. This occurs when an agency imposes a set percentage of PMRS aggregate salary on its pools for total pay increases and performance awards, and the higher ratings received by higher-graded employees translate into larger merit increases, leaving a smaller amount of funds remaining for performance awards.

Another nonperformance-related factor which determines the amount of funds available for PMRS merit increases and performance awards is the positions of PMRS employees in their salary ranges. Because pools with large concentrations of employees in the lowest third of the salary range

tend to use up more funds for merit increases, less money is left for performance awards. This occurs because such employees who are rated fully successful or above must receive full merit increases.

The effects of nonperformance-related factors on performance award amounts among pools in the agencies we reviewed were evident. As shown in table 4.6, BLM's fiscal year 1985 performance awards for GM-15s rated two levels above fully successful ranged from a low of \$1,016 to a high of \$1,280. At BOR, awards for similarly rated GM-15s ranged from \$3,282 to \$4,286.

We noted similar variations among pools at FAA and OPM as shown in table 4.9. For example, at FAA, a GM-14 employee rated one level above fully successful in pool 1 received \$2,043—more than seven times the performance award received by a counterpart in pool 2. At OPM, a GM-15 rated two levels above fully successful in pool 1 received almost \$2,500 more than a GM-15 in pool 2 with the same rating. At FAA, 36 units operated as PMRS pools, while OPM used 23 pools.

Table 4.9: Ratings Distributions and Average Fiscal Year 1985 Performance Awards in Selected Pools at FAA and OPM^a

Rating ^b	GM-13		GM-14		GM-15	
	Percent with rating	Average performance award for rating	Percent with rating	Average performance award for rating	Percent with rating	Average performance award for rating
2 levels above FS	•	\$ •	2	\$4,085	15	\$4,806
1 level above FS	26	1,730	33	2,043	27	2,403
FS	74	0	64	0	58	0
Pool 2 at FAA						
2 levels above FS	59	\$471	52	\$556	75	\$654
1 level above FS	12	235	23	278	11	327
FS	29	0	25	0	14	0
Pool 1 at OPM						
2 levels above FS	•	•	3	\$4,374	9	\$6,035
1 level above FS	50	\$1,541	30	1,860	22	2,294
FS	50	416	64	502	61	610
Pool 2 at OPM						
2 levels above FS	6	\$2,348	9	\$2,978	25	\$3,548
1 level above FS	46	997	32	1,168	15	1,357
FS	49	0	55	0	55	0

^aPercentages may not add to 100 due to rounding or because ratings below fully successful were not included.

^bFS—fully successful.

Pressures on the Distributions of Ratings Continue

As discussed in chapter 2, the PMRS legislation prohibits agencies from prescribing the distribution of performance ratings among employees. (See pp. 20 to 21.) Despite this prohibition, the agencies we studied were faced with several factors which exerted pressure to influence ratings distributions. These factors included (1) general budgetary constraints; (2) the maximum amount of money the legislation permits to be spent on performance awards; (3) legislative requirements for performance awards for employees rated two levels above fully successful; and (4) the desire to give substantial performance awards for quality performance.

For example, IRS' draft PMRS performance appraisal plan discussed pool managers' responsibilities for performance ratings in light of managing their performance awards budgets:

"In order to properly manage their performance awards budgets, plan managers are responsible for the distribution of ratings of all PMRS employees under their authority. As such, plan managers shall review the distribution of ratings and take appropriate measures with lower levels of management when necessary."

In its PMRS guidance and regulations, OPM has stressed the importance of agencies' managing PMRS performance ratings and appraisal systems to assure that accurate and equitable ratings are assigned to all PMRS employees. For example, the August 30, 1985, PMRS regulations contain the following requirements on appraisal procedures:

"An agency may not prescribe a distribution of levels of ratings for employees covered by this subpart. However, in order to provide for the equitable distribution of merit increases and performance awards under the PMRS, agencies must establish procedures, such as reviews of standards and ratings for difficulty and strictness of application, to ensure that only those employees whose performance exceeds normal expectations are rated at levels above 'Fully Successful.'"

After fiscal year 1985, agencies are required to grant each employee rated two levels above fully successful performance awards of at least 2 percent of salary. The incentive for agencies to influence ratings distributions was demonstrated by an exchange of comments between an agency and OPM regarding this matter. The agency suggested allowing performance awards lower than 2 percent for employees rated two levels above fully successful if paying such awards would exceed the legislatively mandated 1.5 percent-of-payroll limit on the awards fund. OPM responded:

"The minimum 2 percent award for 'Outstanding' [two levels above fully successful] employees is statutorily based and cannot be changed by OPM in regulation. The spending limitations specified in the law underscore and support the need for an integrated approach of managing both the appraisal process and the pay process."

A May 20, 1985, internal FAA memorandum on PMRS performance appraisal expressed concern that the amounts of individual performance awards within a pool could be insignificant if the ratings distribution was too high. The memorandum suggested that resource managers use the first year's PMRS ratings profile for the second year's ratings:

"Unrealistically high percentages of 'exceptional' [one level above fully successful] and 'outstanding' [two levels above fully successful] summary ratings in local merit pay units will distort the PMRS payout. FAA's agencywide PMRS rating profile for last year was excellent and should be used as a model for this year. Last year's profile was: 13 percent rated outstanding, 38 percent exceptional, and 48 percent fully acceptable [fully successful]. One effect of substantially exceeding these exceptional and outstanding percentages within a merit pay unit will be to sharply reduce

the amount of each PMRS employee's performance award. . . . The fund is diminished rapidly when a disproportionately high percentage of employees are rated outstanding, thus entitling them to automatic merit increases equalling full within grade step increases."

A DOI official expressed his opinion to us that, although the law specifically prohibits a prescribed distribution of ratings, in actuality the law and OPM regulations force the distribution of ratings because agencies cannot give performance awards to an undefined number of employees rated one level and two levels above fully successful if they cannot afford them. Thus, he believed that money, rather than performance, was driving PMRS.

Conclusions

PMRS established the framework of a performance-based incentive system designed to monetarily reward employees for performing their best possible work. During the first year of PMRS operations, most employees in the agencies we reviewed received merit increases that were equivalent to or larger than the within-grade increases they would have received under the General Schedule. Thus, a major PMRS objective of providing greater equity in salary increases for covered employees appears to have been accomplished. Yet to be dealt with, however, is the problem caused by nonperformance-related factors. These factors created inequities under merit pay and are now causing performance awards for employees with the same grade and rating to vary widely under PMRS. In our opinion, the variation in performance award amounts is a significant shortcoming of PMRS which could result in many employees believing the system is unfair.

It is possible that this difficulty could be overcome as agencies gain experience under PMRS. But as long as agencies must limit the funds to be made available for general pay increases, merit increases, and performance awards, it is not apparent to us how agencies can completely overcome the effects of nonperformance-related factors.

Recommendation

We recommend that the Director, OPM, clarify the formula in current OPM guidance and regulations for calculating PMRS general pay increases. Specifically, the Director, OPM, should provide more detailed guidance to agencies that would explain

- how PMRS general pay increases could have been miscalculated using OPM's previous guidance and regulations;

- what results could occur from seemingly small miscalculations of general pay increases on PMRS employees' positions in the salary range and their subsequent merit increases; and
- how such miscalculations can be corrected.

Because PMRS is a new system and our review covered only the first year's operations, we are not making any other recommendations at this time. Whether other changes are needed to correct the difficulties we found in the distribution of performance awards will depend on future experience under the system.

Survey Respondents Are Unconvinced That Intended Benefits of PMRS Are Being Realized

To obtain indications of employee attitudes about PMRS, we surveyed 634 PMRS employees and 234 supervisors of PMRS employees in the five agencies we reviewed in Denver, Colorado, and Washington, D.C. PMRS was in the early stages of implementation at the time of our survey. Consequently, employees at the agencies we surveyed lacked extensive experience under this system. Some employees were not aware that a new system had been implemented, and many others did not understand the system.

Despite PMRS' intended improvements and agencies' progress in implementing the system, only 31 percent of the employees and 40 percent of the supervisors we surveyed believed that PMRS was an improvement over merit pay. It remains to be seen, as employees gain additional knowledge of and experience with PMRS, whether the preliminary attitudes of these employees will continue. Because we did not obtain a statistically representative sample at all locations, these views are not projectable to other PMRS employees and supervisors.

Respondents Indicated Problems During Transition to PMRS

Employee and supervisor respondents expressed concerns with the implementation of the new system. Specifically, these included (1) lack of adequate information and training on implementation of PMRS and (2) inadequate PMRS regulations and guidance.

Respondents Believed Information and Training on PMRS Were Lacking

The Congress, recognizing the importance of training to improve performance evaluation, required training in the PMRS legislation. In addition, OPM regulations stipulate that agencies must establish performance management plans that include provisions for (1) communicating to PMRS employees the system's purpose and how it works and (2) training PMRS employees and their supervisors on the system's operations.

The agencies we visited had made attempts to inform their employees about PMRS, primarily through the issuance of internal memoranda. Yet, 46 percent of the supervisor respondents felt the level of training they had received, including training on the appraisal process, was inadequate. Twenty-seven percent of employees surveyed responded that they understood very little or nothing at all about PMRS, ranging from 10 percent at OPM to 41 percent at IRS. According to responses to open-ended questions, employees and supervisors had concerns about having received very little or no information and training on PMRS. At one

agency, employees were under the impression that PMRS became effective in October 1985 rather than October 1984. Specific responses about the lack of information and training included:

- "No basis to answer because I am not aware of this new system nor have I had any training. I am scheduled to attend a training session in October or November [1985]."
- "We have received inadequate training on a system that has been in effect for 1 year. I am, therefore, unable to explain expectation-setting to my two employees as we start fiscal year 1986."
- "[I] cannot answer this question - we have been working under the concepts of the old merit pay system throughout fiscal year 1985."
- "I have no information at all on PMRS - the entire questionnaire is premature."
- "Until I filled out this questionnaire I didn't realize that PMRS was in place."

Many Supervisors Believe PMRS Regulations and Guidance Are Inadequate

Of the 156 supervisors who expressed an opinion, 54 percent believed OPM regulations and guidance on PMRS were inadequate. When asked about their agency's guidance, 48 percent of the 200 supervisors expressing an opinion believed that the guidance was inadequate.

The supervisors were given an opportunity to provide additional comments regarding the information and guidance on PMRS through open-ended questions. Thirty-eight percent of the supervisors responding to open-ended questions reemphasized their concerns that PMRS information and guidance were inadequate for proper implementation.

Survey Respondents Expressed PMRS Concerns Similar to Those Expressed by Merit Pay Employees

Our 1984 report on merit pay concluded that merit pay employees in the three agencies reviewed had negative perceptions of the merit pay system. Between 37 and 46 percent of the employees in each agency supported the concept of merit pay, but fewer than 10 percent favored retaining the system as implemented in their departments.

Generally, this attitude appears to have persisted among the PMRS employees and supervisors we surveyed. Concerns and problems similar to some that had been expressed by merit pay employees were also expressed by our PMRS survey respondents. These included (1) the lack of sufficient funds under PMRS to adequately reward performance and the inability of PMRS rewards to motivate better performance, (2) employee concerns that performance rating distributions were being

prescribed, and (3) performance standards not being established early in the appraisal period.

Respondents Questioned Adequacy of Monetary Rewards Under PMRS

PMRS' objectives were to recognize, reward, and motivate quality employee performance by monetary means. We asked the survey participants if they felt the system was able to adequately reward and motivate employees to perform better.

According to 59 percent of employee respondents, total monetary compensation they received for 1984 performance under PMRS did not adequately reward them for that performance. In addition, 56 percent of supervisors responding believed their PMRS employees had been inadequately rewarded for their 1984 performance. The following narrative comments of respondents reflect the employees' and supervisors' perceptions that total monetary rewards received in fiscal year 1985 under PMRS were inadequate.

- "More monetary incentives are needed. . . ."
- "While PMRS is certainly better than merit pay in providing full comparability, the total amount of dollars available to reward exceptional performance is still much too limited to make the system really effective. . . ."
- "I do not feel that the pay potential is equal to the GS [general schedule] systems."
- "Generally, organizational recognition in the form of awards (other than \$(dollars)) is more important. While I am interested in \$(dollars), the amount in PMRS is so little, even at the highest level, that it is not of significant importance."

Fifty percent of the performance award recipients who responded to our survey believed the dollar amounts of the performance awards they received for 1984 performance were inadequate. In addition, of the 59 percent of employees responding who felt that total rewards they received under PMRS for the 1984 appraisal period were inadequate, 35 percent believed that the dollar amounts of the performance awards they received were inadequate.

When asked about the adequacy of funding for performance awards, 50 percent of the employees and 65 percent of the supervisors who responded indicated that funding was inadequate. Of those supervisors expressing an opinion, 67 percent believed that performance awards under PMRS need to be changed, 19.5 percent believed the performance

awards should be abolished, and 13 percent wanted performance awards to be continued as is. For employee respondents, these percentages were 60 percent, 27 percent, and 13 percent, respectively.

Although 33 percent of PMRS employees who responded indicated that performance awards motivate them to perform better, 52 percent indicated that they did not. In addition, 15 percent stated they did not know. Of employee respondents who had ratings above fully successful, 49 percent said they were not motivated by PMRS performance awards. Additionally, 55 percent of the supervisors believed that performance awards do not motivate better performance.

Seventeen percent of the employees and 15 percent of the supervisors responding to open-ended questions offered narrative comments indicating that they believed PMRS does not motivate better performance and demoralizes those who are not rewarded. According to some of these respondents, this lack of motivation and demoralization is attributed to

- adversarial working relationships caused by top managers being awarded most of the PMRS funds and leaving a much smaller pool of funds for the GM-13s and 14s,
- belief that pay increases and awards are so limited they cannot seriously be considered as motivators, and
- belief that performance appraisals are too subjective and create an unfair distribution of ratings.

Survey Respondents' Concerns About Performance Ratings Distributions

Although PMRS prohibits agencies from prescribing distributions of levels of performance ratings, 68 percent of the supervisors responding felt they were pressured, at least to some extent, to distribute ratings to their PMRS employees in a prescribed manner. The survey respondents also had the opportunity to comment further on forced distribution of ratings by responding to open-ended questions in the survey. Of the 558 employees and 206 supervisors giving narrative responses, 34 percent of the employees and 35 percent of the supervisors either perceived, or were convinced, that the distribution of ratings was forced. Some of these comments indicated a belief by employees and supervisors that quotas were set by top management and that ratings were sometimes changed by second-line managers or higher management officials to meet those quotas.

The following comments reflect these respondents' concerns about forced distribution of ratings:

- "Managers examine the award money available, rank the relative performance of subordinates, and then decide how to rate employees so that funds are divided as they deem appropriate. Ratings that produce these results are then derived. Every appraisal system works this way; belief in some totally objective formula for rating complex and varied management jobs is a snare and a delusion."
- "Something should be done to eliminate what my manager does—he rotates awards yearly so that all managers will receive one if they do barely acceptable—no incentive."
- "Do away with the notion that ratings distribution should approximate [the] bell curve. This has the effect of preventing some very deserving employees from getting the rating and thus the compensation they honestly deserve. It is a disincentive to good performance and runs 100 percent contrary to suggested management theory."

Of additional concern to the survey respondents was the subjectivity involved in rating performance. Of the employees and supervisors responding to open-ended survey questions, 33 percent of the employees and 23 percent of the supervisors indicated a belief that the rating process was driven by favoritism and not based on performance. Some suggested that differences among supervisors' managerial styles and attitudes towards a recognition system made it difficult, if not impossible, to have an objective rating system.

**Respondents Stated That
Performance Standards
Were Not Established
According to OPM Guidance**

PMRS requires that performance standards and critical job elements be communicated to employees in writing at the beginning of each appraisal period. OPM regulations define the beginning of the appraisal period as normally within 30 days. However, of the 88 percent of employee respondents who indicated that they had standards set for the 1985 performance appraisal period, about 50 percent of the employee respondents received their performance standards more than 30 days into the appraisal period.

Establishing performance standards early in the appraisal period enables the supervisor and the employee to know exactly what performance is expected. PMRS requires agencies to establish performance standards which, to the maximum extent feasible, use objective criteria to accurately evaluate performance. According to 68 percent of the supervisor respondents, performance standards helped them to evaluate the job performance of their PMRS employees.

Conclusions

Acceptance of any system is largely dependent on proper implementation to assure understanding of the system's benefits. More than one-quarter of the surveyed employees did not understand how PMRS—the pay for performance system under which they were actually being paid—operated. Moreover, 46 percent of the supervisors responding did not believe they had been adequately trained on the new system. In addition, some of the negative perceptions PMRS employees had of the merit pay system appear to have been transferred to PMRS.

Because the PMRS legislation was passed in November 1984 and implemented retroactively to October 1984, the agencies did not have sufficient time to adequately prepare for its implementation. This limited preparation time contributed to varied levels of understanding, from total unawareness of the system and its implementation by some employees and supervisors during the transition year to full understanding and support of the system's underlying concepts by others. While we recognize that the time frame for implementing PMRS and its retroactive requirements placed greater pressure on agencies, agencies should have done more to ensure that information about the system was being communicated to affected employees.

Request Letters

House of Representatives

Committee on Post Office and Civil Service

Washington, D.C. 20515

TELEPHONE (202) 225-3084

January 24, 1985

Honorable Charles A. Bowsher
Comptroller General of the
United States
General Accounting Office
Washington, D. C. 20548

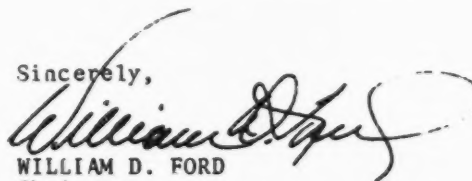
Dear Mr. Bowsher:

Representative Mary Rose Oakar, Chairwoman of the Subcommittee on Compensation and Employee Benefits, recently contacted me regarding her concern with the implementation by the Office of Personnel Management of the changes in the merit pay system enacted by Congress as Public Law 98-615.

It appears that problems with implementing this new system have already started to emerge. In this regard, I would appreciate your reviewing and reporting to the Subcommittee on the implementation of the legislative changes to the merit pay system in selected Federal agencies. As part of this effort, I would appreciate a review of the cash award and other incentive programs. Also, I would appreciate your reporting to the Subcommittee on a regular basis on the progress of the study. If you have any questions, please contact Jerry Klepner, Staff Director, Subcommittee on Compensation and Employee Benefits, at 226-7546.

With kind regards,

Sincerely,



WILLIAM D. FORD
Chairman

WDF:prp

House of Representatives

Committee on Post Office
and Civil Service

Washington, D.C. 20515

TELEPHONE (202) 225-4064

January 11, 1985

The Honorable William D. Ford, Chairman
Committee on the Post Office and Civil Service
309 Cannon House Office Building
Washington, DC 20515

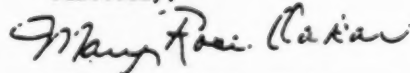
Dear Chairman Ford:

Recently I have become concerned with the implementation by the Office of Personnel Management of the changes in the merit pay system enacted by Congress as Public Law 98-615.

It appears that problems with implementing this new system have already started to emerge. In this regard, I would appreciate your requesting the General Accounting Office to review and report on the implementation of the legislative changes to the merit pay system in selected Federal agencies. As part of this effort, I would appreciate GAO's reviewing the cash award and other incentive programs. I would also appreciate their reporting to my Subcommittee on a regular basis on the progress of the study.

With kindest personal regards,

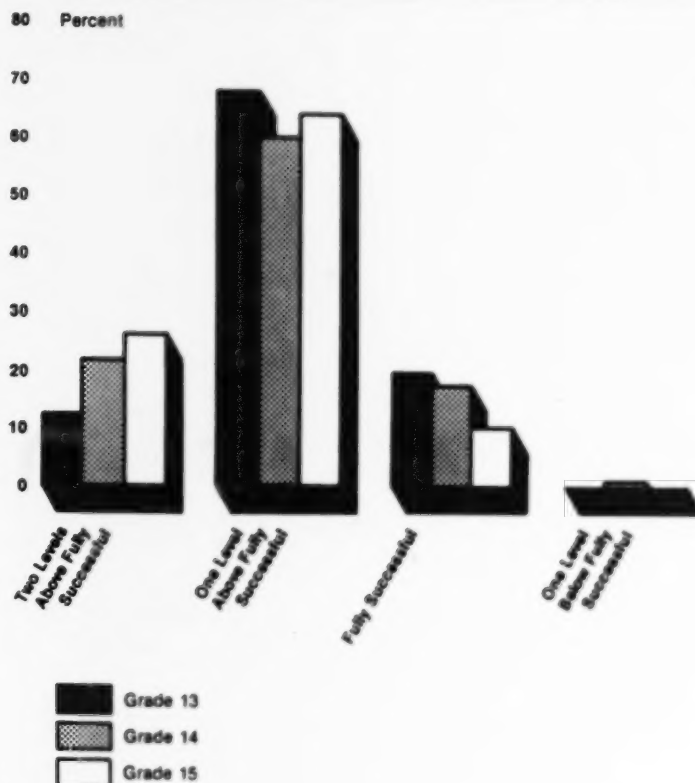
Sincerely,



Mary Rose Oskar, Chair
Subcommittee on Compensation
and Employee Benefits

Percentage Distribution of Ratings by Grade for Five Agencies

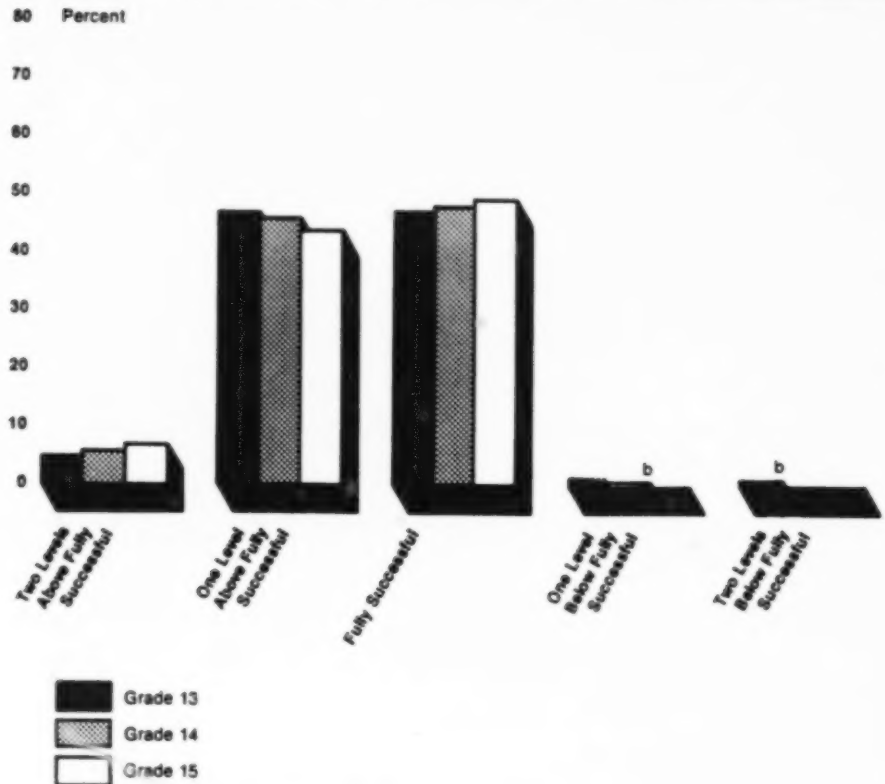
Figure II.1: Percentage Distribution of Ratings by Grade* at BLM



*Percentages may not add to 100 due to rounding.

Appendix II
Percentage Distribution of Ratings by Grade
for Five Agencies

Figure II.2: Percentage Distribution of
Ratings by Grade^a at BOR

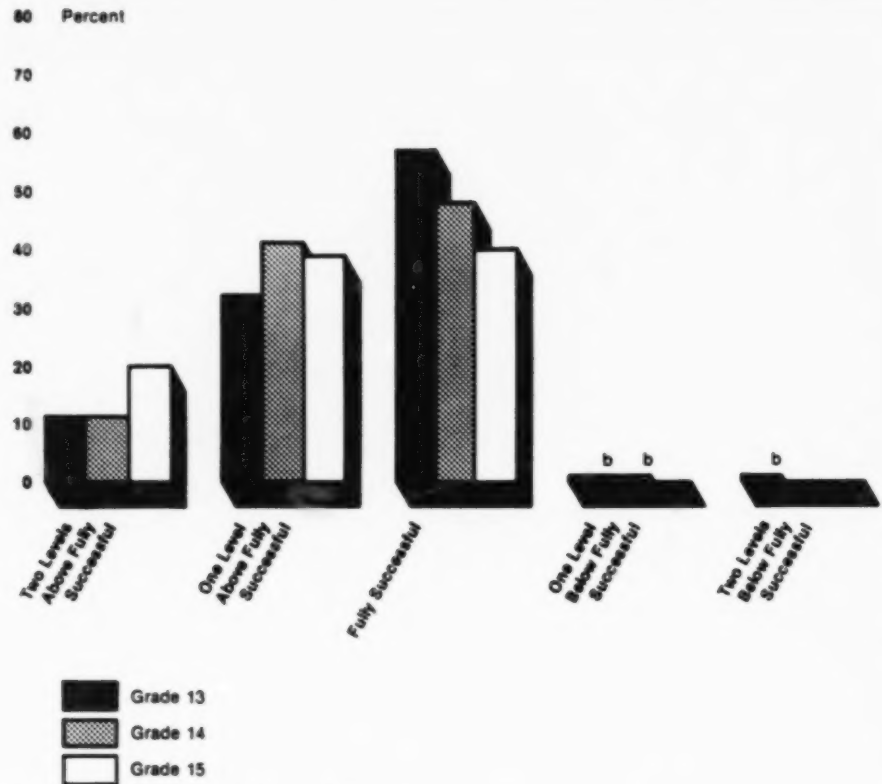


^aPercentages may not add to 100 due to rounding.

^bLess than 1 percent

Appendix II
 Percentage Distribution of Ratings by Grade
 for Five Agencies

Figure II.3: Percentage Distribution of
 Ratings by Grade^a at FAA

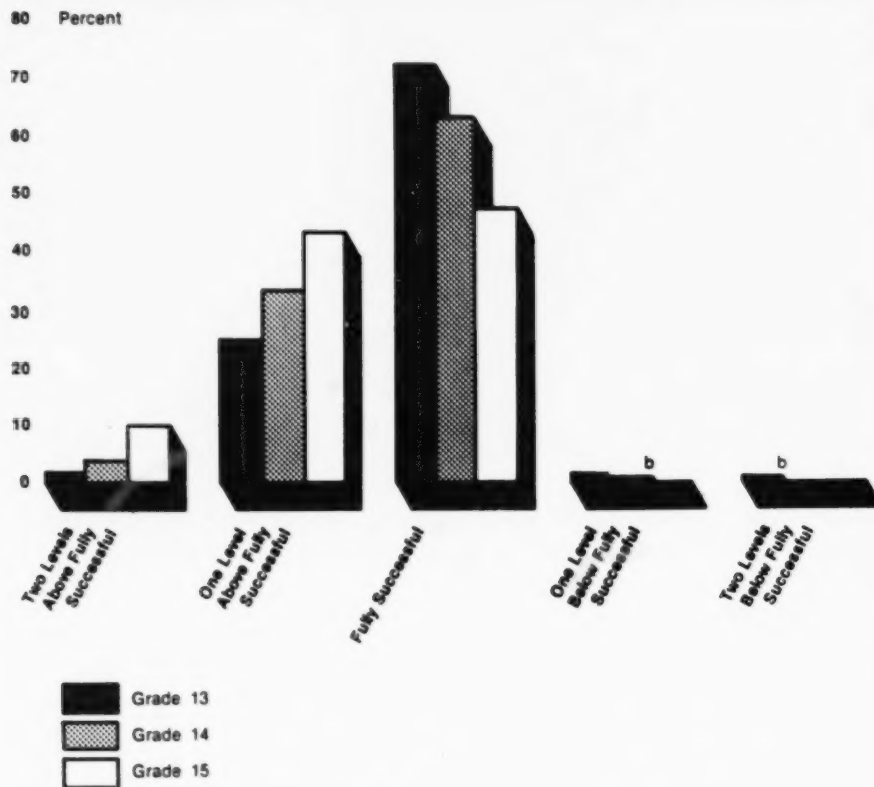


^aPercentages may not add to 100 due to rounding.

^bLess than 1 percent

Appendix II
 Percentage Distribution of Ratings by Grade
 for Five Agencies

Figure II.4: Percentage Distribution of
 Ratings by Grade^a at IRS

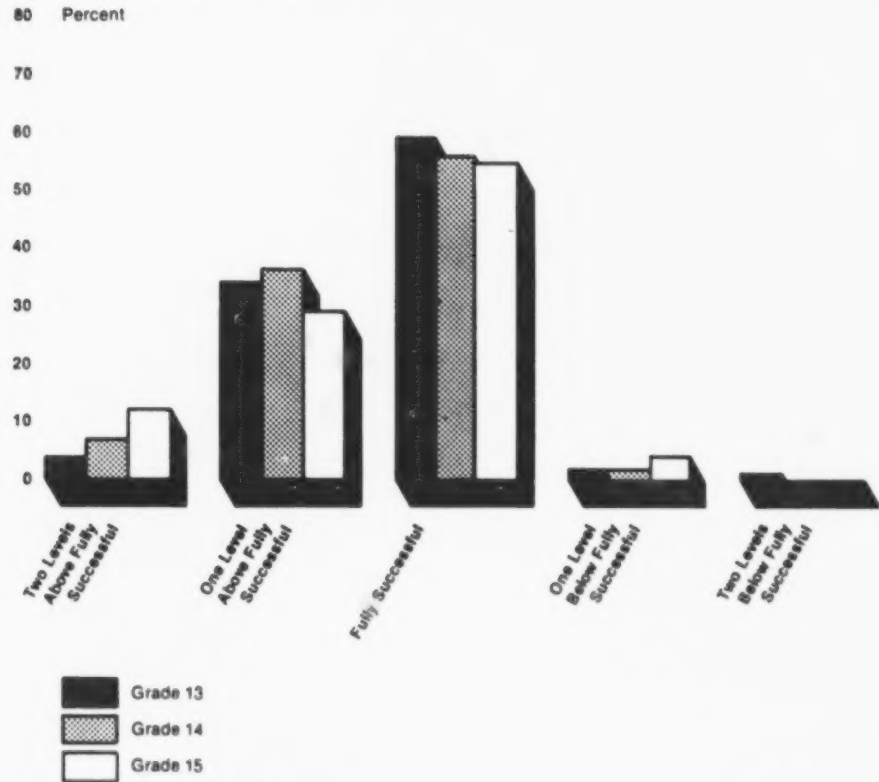


^aPercentages may not add to 100 due to rounding.

^bLess than 1 percent

Appendix II
 Percentage Distribution of Ratings by Grade
 for Five Agencies

Figure II.5: Percentage Distribution of
 Ratings by Grade* at OPM



*Percentages may not add to 100 due to rounding.

Survey of PMRS Employees and Supervisors

Our survey objective was to obtain indications of employee and supervisor attitudes on and experience with PMRS. We surveyed PMRS employees and supervisors at the Bureau of Land Management, Bureau of Reclamation, and Office of Personnel Management in Denver, Colorado, and Washington, D.C. We also surveyed employees and supervisors at the Federal Aviation Administration and Internal Revenue Service in Washington, D.C. In total, the survey covered 634 employees and 234 supervisors. These agencies had about 2,400 PMRS employees and supervisors. To conduct our survey, we developed and administered two different data collection instruments. One instrument, containing 30 questions, was developed for PMRS employees and a second, containing 23 questions, was developed for PMRS supervisors.

The survey asked these employees and supervisors about the following aspects of PMRS:

- extent to which PMRS is understood, overall impressions of PMRS, and opinions about what the future of PMRS should be;
- adequacy of total pay increases and rewards under PMRS;
- adequacy of performance standards and the appraisal system;
- adequacy of amount of performance awards received;
- extent to which money and performance awards motivate job performance; and
- adequacy of (1) OPM regulations and guidance on PMRS, (2) guidance issued by the agencies implementing PMRS, and (3) training on PMRS, including the related appraisal process.

We used the Statistical Package for the Social Sciences computer program to analyze the responses obtained. In total, we analyzed over 24,400 pieces of data.

For the agencies we visited in Denver, the universe consisted of 419 individuals, including 317 PMRS employees and 102 supervisors. We received responses from 273 employees (86 percent of the universe) and 81 supervisors (79 percent of the universe).

Because of the large number of employees in the agencies' Washington, D.C., offices, we randomly selected 648 employees for the survey. From this sample, we obtained responses from 361 employees (56 percent of our sample). We also administered the instruments to and obtained responses from 153 supervisors.

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